Supreme Court, U. S.
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IN THE

# Supreme Court of the United States

October Term, 1977.

## No. 77-1869.

ELI LILLY AND COMPANY,
*Petitioner,*

*v.*

SMITHKLINE CORPORATION,
*Respondent.*

## RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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## COUNTERSTATEMENT OF QUESTIONS PRESENTED.

If this case were to be accepted for review, the questions presented would be whether the Court of Appeals was correct in holding:

(a) that the relevant product market analysis by the District Court comported with the standards enunciated by this Court (21a);[1]

(b) that, under Rule 52(a) and the decisions of this Court, the relevant product market findings of the District Court were not to be disturbed unless clearly erroneous, and that they were not clearly erroneous (21a);

(c) that the District Court's characterization of Lilly as a monopolist was supported by the evidence (22a); and

(d) that Lilly used its monopolistic power to restrain competition (22a-23a).

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1. Page citations identified by the letter "a" refer to the petitioner's Appendix. "FF" refers to the District Court's Findings of Fact. Portions of the record other than those appearing in petitioner's Appendix are identified by reference to the Joint Appendix ("JA") filed in the Court of Appeals.

## COUNTERSTATEMENT OF THE CASE.

This is an action seeking injunctive relief and treble damages for violation of Section 2 of the Sherman Act.[2] The relevant product market is the nonprofit hospital market for a class of antibiotic drugs known as cephalosporins. The relevant geographic market is the United States.

The District Court found that the defendant, Eli Lilly and Company ("Lilly"), had monopoly power in the cephalosporin market; that it unlawfully used its monopoly power to foreclose and exclude competition by means of a rebate program known as the Revised Cephalosporin Savings Plan ("Revised CSP"); and that the plaintiff, SmithKline Corporation ("SmithKline") had been injured in its business and would suffer further injury as a result of the Revised CSP. The District Court entered an order permanently enjoining the use of the Revised CSP or any similar plan.[3] Lilly appealed.

The Court of Appeals found that the District Court's analysis of the relevant product market comported with the standards enunciated in *Cellophane*[4] and *International Boxing;*[5] that under this analysis, the market where there is true economic rivalry in this case is composed of cephalosporin antibiotics; that Lilly enjoyed monopoly power in this market by reason of its market share (between 100% and 89.8%) and the fact that its competitors did not have the actual or potential ability to invade this share; and that Lilly, through the Revised CSP, used its monopoly power

2. 15 U. S. C. § 2.

3. There is to be a separate trial to ascertain damages.

4. *United States v. E. I. duPont de Nemours & Co.*, 351 U. S. 377 (1956).

5. *International Boxing Club, Inc. v. United States*, 358 U. S. 242 (1959).



to subvert the normal interplay of price, supply and demand and to restrain competition. Having so concluded, the Court of Appeals affirmed (5a-24a).

The facts of the case are set forth in the opinion of the District Court (Judge Higginbotham) in 123 detailed findings supported by extensive record references (36a-71a). A succinct summary is to be found in the opinion of the Court of Appeals (Judge Aldisert) (8a-15a). We rely upon these statements and see nothing to be gained by a further summary on our part.

The statement of the case in the petition is unreliable in that it omits or glosses over many facts which were deemed significant by the District Court and the Court of Appeals. In particular:

1. The petition omits to state that Keflin, Lilly's largest selling cephalosporin (accounting for more than 50% of its cephalosporin sales), has been totally immune to price competition since its introduction in 1964, notwithstanding its high price and profit margin (approximately 75%) (18a, FF 48[6] at 49a, 92a; FF 45 at 47a-48a; JA 1371).

2. The petition does not explain the part played by the hospital pharmacist in the purchase of drugs for hospital use. The process starts with the formulary, a list of drugs approved for use in the hospital. The hospital pharmacist maintains an inventory of the formulary drugs and periodically makes purchases to replenish the same. The quantity to be purchased corresponds to the quantity previously dispensed in response to physicians' prescriptions.[7] The physicians determine the amount to be pur-

6. Two Findings of Fact numbered 48 appear at 49a. This reference is to the first.

7. The pharmacist must fill a prescription with the drug specified by the physician (FF 34 at 43a).

chased. The brand to be purchased (if there is more than one) and the price to be paid are determined by the pharmacist (FF 30 at 41a-42a; FF 34 at 43a).

3. The petition omits to state that, while prescribing physicians are not cost conscious, hospital pharmacists are primarily interested in cost. It is the pharmacist's responsibility to buy at the lowest cost consistent with quality. Where the same drug is offered by equally reputable suppliers (as in the case of cefazolin, supplied by SmithKline under the brand name "Ancef" and by Lilly under the brand name "Kefzol"), the pharmacist's choice is virtually dictated by price. Consequently, the pharmacist is the point of entry for price competition in the sale of hospital drugs [8] (FF 48-49 at 49a).

4. Having omitted all reference to the hospital pharmacist and price competition, the petition does not explain the effect of the Revised CSP on the pharmacist's purchasing decision. Under the Revised CSP, if a pharmacist wishing to replenish his stock of cefazolin received a lower bid on SmithKline's Ancef than on Lilly's Kefzol and awarded the contract to Ancef, he would lose his so-called "bonus" rebate of 3% on Lilly's Keflin and Keflex, both of which are covered by Lilly patents and thus protected

8. Where two different drugs can be prescribed more or less interchangeably, competition occurs at the level of the physician rather than the pharmacist. Manufacturers' sales representatives (called "detailmen") call on the physicians, explain the clinical and pharmacological advantages of their product and urge the physicians to prescribe the same. This is the kind of competition that prevailed between Lilly's cefalothin ("Keflin") and SmithKline's cefazolin ("Ancef") (FF 75 at 55a; FF 85-88 at 59a-60a; FF 103 at 65a-66a). Judge Higginbotham found that the Revised CSP would cripple Ancef in its competition with Keflin as well as in its competition with Kefzol by destroying profitability and making it uneconomic for SmithKline to continue promoting Ancef through expensive sales representatives (FF 109 at 67a-68a; FF 119 at 70a).



from direct competition by SmithKline (FF 61 at 51a; FF 90-92 at 60a-62a).

The only way SmithKline could compensate the pharmacist for the loss of the "bonus" (and thus retain the business) would be to increase its own rebate on Ancef by an equal dollar amount. Since hospital purchases of Keflin and Keflex are much larger than their purchases of cefazolin, an amount equal to 3% of the former represents a much higher proportion of the latter, the actual percentage figure being dependent on the hospital's "mix" of the three drugs. The evidence showed that the additional rebate needed to compensate the pharmacist would average about 16% and would rise to 35% in the case of larger hospitals, whose "mix" is heavily weighted toward Keflin and Keflex (FF 45 at 47a-48a; FF 105 at 66a; 98a).

These percentages (i.e. percentages in the order of 16%-35%) measure the penalties Lilly imposed on pharmacists who chose to deal with SmithKline. Penalties of this magnitude could not be ignored by the pharmacist.[9] Nor could they be matched by SmithKline. The economic effect of the plan, if not restrained, would have been to squeeze SmithKline's Ancef out of the market, relieving the direct competitive pressure on Lilly's Kefzol and the indirect pressure on Lilly's Keflin and restoring Lilly's virtually complete monopoly (FF 109 at 67a-68a; JA 301).

9. Judge Higginbotham noted that, "if one disregards the economics of the market place" hospital pharmacists were free to buy whatever combination of products they might choose. However, he concluded that "the economics of the market place precluded that freedom of choice for most pharmacists" (80a-81a).

Lilly's efforts to becloud the economic effects of the Revised CSP by reference to the theoretical possibility that hospitals could meet the bonus rebate requirements by minimal purchases of Kefzol, or by purchases of Kafocin or Loridine can be ignored. In practice, the number of hospitals following this theoretical course was negligible (FF 92 at 61a-62a).

5. Petitioner's characterization of the Revised CSP as "package pricing" is misleading. The "bonus" rebate was not a package discount, it was a penalty imposed for buying cefazolin from SmithKline. The amount of the penalty (unlike a normal package discount) varied from hospital to hospital depending on the hospital's purchases of Lilly's patented products (Keflin and Keflex) (FF 105 at 66a).

From Lilly's point of view, there was no significant economic risk. If the pharmacist knuckled under and bought Lilly's Kefzol rather than SmithKline's Ancef, most of his bonus rebate would be paid in the form of Keflin and Keflex which cost Lilly very little to produce (FF 106 at 67a). Thus, the penalty imposed on purchases of the non-exclusive product with which SmithKline could compete (cefazolin) was measured by purchases of the exclusive products with which SmithKline could not compete (Keflin and Keflex) and was, in effect, financed by the monopoly profits on these products. This was what the District Court referred to when it concluded that:

> "Lilly, by linking its most powerful cephalosporin products, Keflin and Keflex, to its unpatented product, Kefzol, has unlawfully used its monopoly power to foreclose competition in and to exclude competition from the cephalosporin market." (113a)

And what the Court of Appeals referred to when it found:

> "In sum, the act of willful acquisition and maintenance of monopoly power was brought about by linking products on which Lilly faced no competition—Keflin and Keflex—with a competitive product, Kefzol. The result was to sell all three products on a non-competitive basis in what would otherwise have been a competitive market for Ancef and Kefzol." (22a)



6. The petition neglected to state the intent and objectives of Lilly's Revised CSP. On this point, there is no need for speculation; Lilly's documents say it all. As to the linkage of Kefzol to Keflin and Keflex, one of the avowed objectives of the task force that designed the Revised CSP was "utilizing our large dollar sales base; and tie-in sales within legal limits" (JA 1286, Ex. P-72). As to the effect of the bonus rebate on SmithKline, Lilly's manual explaining the Revised CSP to Lilly salesmen contained an illustration in which, to use Lilly's words, "competition [meaning SmithKline] would have to bid its product at 20.5 percent free goods [meaning a 20.5% compensatory rebate] to match our effective price." [10] As to the overall objective, Lilly's goal, announced to its organization, was to capture 75% of the hospital market for cefazolin, which, when added to its exclusive products (Keflin and Keflex), would have maintained its share of cephalosporins above 90%. Equally important, the 25% share that Lilly was prepared to concede to SmithKline would have been too small to warrant the kind of intensive marketing through detailmen necessary to compete with Lilly. SmithKline would have been eliminated as an effective competitor (JA 1288, Ex. P-78; FF 86 at 59a; FF 109 at 67a-68a).

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10. Judge Higginbotham noted that in one instance, Lilly estimated that SmithKline would have to offer a 38% rebate on Ancef sales in order to match Lilly's combined bonus and volume rebates on Keflin, Keflex and Kefzol (98a).

## COUNTERARGUMENT.

### I.

Contrary to Lilly's assertion, this case does not present an opportunity for this Court to set out the boundaries of business conduct permitted to lawful monopolists. Nor will the decision of the Court of Appeals inhibit competition by lawful monopolists. This case is *sui generis*. The structure of the Revised CSP is unique and unprecedented. Within the hospital supply industry neither Lilly nor any other manufacturer has ever previously attempted to link its products in this fashion. Outside the hospital supply industry, the idea would be unthinkable because the plan produces rebates that vary widely from one customer to another without regard to cost savings. Such pricing would flagrantly violate the Robinson-Patman Act [11] were it not for the provision in that Act exempting sales to non-profit hospitals.[12] Lilly was careful to limit its plan to this class of customer.

Again contrary to Lilly's assertion, the decision here does not conflict with the decision in *Telex*.[13] Judge Higginbotham devoted an entire section of his opinion to *Telex* (106a-110a), pointing out that in *Telex* IBM reduced its prices on individual products and did not link the price of one product to purchases of another (109a). Consistent with this, Judge Higginbotham limited his injunction to plans involving linkage and permitted Lilly to compete on a product-by-product basis (116a-117a).

Lilly's arguments with respect to the operation and effect of the Revised CSP (pp. 17 through 23 of the petition) present nothing more than a quarrel with the District

11. 15 U. S. C. § 13(a).

12. 15 U. S. C. § 13(c).

13. *Telex Corp. v. International Business Machines Corp.*, 510 F. 2d 894 (10th Cir.), *cert. dismissed* 423 U. S. 802 (1975).



Court (and the Court of Appeals) on findings of fact that are amply supported by evidence, largely in the form of documents from Lilly's files. An egregious example is Lilly's rebuke to the District Court and the Court of Appeals for attributing the entire "bonus" rebate to Kefzol, when that was precisely what Lilly told its salesmen to do (FF 93 at 62a). Certainly, the findings of the District Court were not "clearly erroneous" and were properly affirmed by the Court of Appeals. *International Boxing Club, Inc.*, 358 U. S. 242, 252 (1959).

### II.

Lilly's assertion that the Court of Appeals "adopted a new standard" for defining the relevant market is a far fetched effort to attribute a significance to this case that it does not have. There was no occasion for the District Court or the Court of Appeals to adopt a new standard; the relevant market was readily defined by previous decisions of this Court, as Judge Aldisert was careful to point out (17a-21a). Among the indicia pointing to the conclusion that cephalosporins form a relevant market for purposes of Section 2 were:

> 1. Cephalosporins are essential to hospital operation. There is no record of a single hospital that does not stock them. The fact that a product is used by every potential customer shows that there is no realistic substitute for that product.[14] (FF 42 at 46a).

14. Individual physicians may consider other drugs to be interchangeable for treating individual patients, but the aggregate effect of their prescribing decisions in every hospital is to create a demand for cephalosporins that cannot be met by any other drugs (FF 34 at 43a). The hospital demand for cephalosporins in 1974 ($123,000,000) resulted from more than 2 million "patient starts" (i.e., initiations of cephalosporin therapy) by more than 100,000 doctors (FF 43 at 47a; FF 45 at 48a).

2. The price behavior points to the same result. Cephalosporins are relatively expensive on the basis of cost per day of therapy. Yet, there is no price sensitivity or cross elasticity between cephalosporins and other drugs. There have been no reductions in the price of Keflin (the leading cephalosporin) since the mid-1960s. This is in marked contrast to non-cephalosporins where, according to the President of Lilly's Pharmaceutical Division, "it has been the historic characteristic of that market [i.e., the non-cephalosporin market] that within a relatively short period of time competition has forced that relatively high price down rather sharply" (91a). Lilly's witness admitted that such an erosion has not occurred in the price of Keflin (92a). His explanation was:

> "Now I might add that mindful we have a very, very prominent role in an antibiotic market. Mindful of the past history of price evolution in that market we have strived pretty hard to keep the Keflin price where it is. I don't think that Keflin prices have stayed relatively constant by accident. I think a great deal of planning and selling efforts have gone into the situation that prevails today." (102a)

Judge Higginbotham noted that this comment shows Lilly's ability to maintain Keflin prices (102a). He also noted that Keflin's price performance was atypical of other anti-infective drugs, supporting the conclusion that Keflin (and the other lesser cephalosporins) form a separate market for purposes of Section 2 (92a).

3. The high gross profit margins on Lilly's cephalosporins (approximately 75% in the case of Keflin) also point to the absence of competition and the conclusion that cephalosporins form a separate market (FF 45 at 47a-48a; JA 1371).



4. Lilly has promoted cephalosporins as unique drugs (FF 37 at 45a). In mailings to 187,000 physicians, 50,000 pharmacists and the entire Lilly sales force, Lilly called Keflin a "unique antibiotic" (P-20, JA 1186; P-24, JA 1194) and "an entirely new antibiotic" (P-22, JA 1190), and said that the cephalosporins were "a totally different class" (P-34, JA 1208). Also, in reporting to its stockholders, Lilly called cephalosporins an "entirely new chemical class", "a family of new cephalosporin antibiotics with remarkable qualities" and "a new class of broad spectrum antibiotics" (P-21, JA 1188; P-23, JA 1192; and P-25, JA 1196). Finally, Lilly's annual reports set out the sales of "cephalosporins" separately from "other antibiotics" and show that in 1973 cephalosporins accounted for 27% of the consolidated net sales of the company (P-27, JA 1200; P-29, JA 1204).

In truth, it is Lilly, not the Court of Appeals, that seeks to change the definition of relevant market by asserting that limited functional interchangeability is the sole test, even where there is no price sensitivity and no effective competition.

The decisions of this Court point in the opposite direction. *Brown Shoe Co. v. United States,* 370 U. S. 294 (1961); *International Boxing Club, Inc. v. United States, supra.* Under those decisions, the goal of market definition is to ascertain the boundaries of effective competition, and the relevant market is composed of products having the ability, actual or potential, to take significant amounts of business away from one another. Lilly was unable to

demonstrate that any price reduction on any non-cephalosporin had ever taken business away from the cephalosporins or caused a reduction in their prices (90a-92a).

## CONCLUSION.

This case does not present novel questions of antitrust law. There is no conflict with the decisions in other circuits. There is no departure from established legal standards. At most, the petitioner is asking this Court to review findings of fact that have already been properly reviewed and affirmed by the Court of Appeals.

WHEREFORE, it is respectfully submitted that there is no reason to grant the petition and it should be denied.

Respectfully submitted,

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